

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

APPROPRIATED CAPITAL USED IN THE FY 1995 DEFENSE BUSINESS OPERATIONS FUND FINANCIAL STATEMENTS

Report No. 97-081

January 27, 1997

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INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-2884



January 27, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements (Report No. 97-081)

We are providing this audit report for your review and comment. We reviewed Appropriated Capital Used in the FY 1995 Defense Business Operations Fund financial statements as part of our audit of the revenue accounts in the FY 1996 Defense Business Operations Fund financial statements. We performed the audit in response to Chief Financial Officers Act of 1990 requirements for financial statement audits. This report is the fourth in a series of reports dealing with Defense Business Operations Fund revenue issues. We considered management comments on a draft of the report when preparing the final report. Those comments were responsive to the intent of our recommendations and no further response is necessary.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. David C. Funk, Audit Program Director, at (303) 676-7445 (DSN 926-7445) or Mr. Byron B. Harbert, Audit Project Manager, at (303) 676-7405 (DSN 926-7405). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-081
(Project No. 5FD-2020.02)

January 27, 1997

Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements

Executive Summary

Introduction. We identified the misstatement of Appropriated Capital Used in the FY 1995 Defense Business Operations Fund financial statements during our audit of the revenue accounts in the FY 1996 Defense Business Operations Fund financial statements. We performed the audit in response to Chief Financial Officers Act of 1990 requirements for financial statement audits.

Appropriated Capital Used is a revenue account that records revenue resulting from appropriations. For FY 1995, the Defense Business Operations Fund reported approximately \$75.7 billion of revenues from sales and \$.9 billion of revenues from other sources and received \$945 million of appropriations.

This report is the fourth in a series of reports dealing with Defense Business Operations Fund revenue issues. The other reports dealt with the misclassification of an equity transfer as revenue, overstatement of revenues because of intrafund transactions not being appropriately eliminated, and erroneous charges to the Distribution Depot business area for over-ocean transportation of materiel. See Appendix B for details of those reports.

Audit Objectives. The overall revenue accounts audit objective was to determine whether revenues reported on the FY 1996 Defense Business Operations Fund consolidated financial statements were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this portion of the audit, we reviewed FY 1995 financial statements for comparability and determined whether all Defense Business Operations Fund revenue was reported in FY 1995. In addition, we assessed internal controls and compliance with laws and regulations as applicable to the overall audit objective.

Audit Results. The FY 1995 Defense Business Operations Fund consolidated financial statements did not correctly report the appropriated funds used by the Defense Business Operations Fund for commissary operations. As a result, the FY 1995 Defense Business Operations Fund Consolidated Statement of Operations and Changes in Net Position understated revenues and financing sources by \$940 million and overstated the shortage of revenues and financing sources over expenses by a like amount. For details of the audit results, see Part I. In addition, the management control program at the Defense Finance and Accounting Service needs improvement; we identified a material management control weakness in the financial statement preparation process (Appendix A).

By implementing the recommendations made in this report, the Under Secretary of Defense (Comptroller) can improve specific instructions issued to operating accountants. In addition, the Director, Defense Finance and Accounting Service, can

disclose the FY 1995 misstatement in the FY 1996 comparative financial statements and improve controls to correctly report appropriated funds used in the future.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) rescind the memorandum instructing the Defense Finance and Accounting Service to make an accounting entry not complying with DoD policy. We also recommend that the Under Secretary of Defense (Comptroller) establish a management review procedure to ensure that accounting instructions issued to the Defense Finance and Accounting Service and Defense Business Operations Fund Components comply with policies and procedures contained in DoD 7000.14-R, "DoD Financial Management Regulation." We recommend that the Director, Defense Finance and Accounting Service, implement the DoD 7000.14-R, "DoD Financial Management Regulation," requirement that proposed financial statements be compared with those of the prior period to identify any unusual trends, errors, inconsistencies, or departures from established accounting policies. We also recommend the Director, Defense Finance and Accounting Service, correct the errors in the FY 1995 Defense Business Operations Fund Consolidated Statement of Operations and Changes in Net Position and report the departure from applicable accounting principles in the footnotes to the FY 1996 comparative Defense Business Operations Fund financial statements.

Management Comments. We received joint comments on a draft of this report from the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service. Management concurred with two of the five recommendations and nonconcurred with the remaining three recommendations. Management concurred with the recommendation that proposed financial statements be compared with those of the previous period, stating that a comparative procedure was implemented and had identified the difference between the FY 1994 and FY 1995 reports. Management also agreed that the Appropriated Capital Used and Non Operating Changes lines should be restated in the FY 1996 Defense Business Operations Fund comparative financial statements but did not indicate how they planned to implement this recommendation or when. Management nonconcurred with recommendations concerning rescinding accounting instructions to the Defense Finance and Accounting Service, establishing new review procedures for accounting instructions, and reporting the departure from applicable accounting principles for the FY 1995 financial statements in the footnotes to the FY 1996 comparative Defense Business Operations Fund financial statements. See Part I for a discussion of management comments and Part III for the complete text of management comments.

Audit Response. The alternative actions proposed by management satisfy the intent of the recommendations on which there was disagreement.

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Part I - Audit Results

Audit Results

Audit Background

We identified the misstatement of Appropriated Capital Used in the Consolidated Financial Statements of the Defense Business Operations Fund (DBOF) during our audit of "Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund." The revenue accounts audit was performed to meet the requirements of the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990) as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). The Chief Financial Officers Act requires DoD to prepare annual, audited financial statements for the preceding year and submit them to the Director, Office of Management and Budget. These financial statements report the financial position and results of operations of the DBOF Components.

This report is the fourth in a series of reports dealing with revenue issues in the Defense Business Operations Fund. The other reports dealt with the misclassification of an equity transfer as revenue, overstatement of revenues because of intrafund transactions not being appropriately eliminated, and erroneous charges to the Distribution Depot business area for over-ocean transportation of materiel. See Appendix B for details of those reports.

Defense Business Operations Fund. The DBOF, a revolving fund, was established on October 1, 1991, by the Secretary of Defense. The DBOF merged nine existing individual stock and industrial funds, along with five DoD commercial operations or business organizations previously funded with appropriated funds.

DBOF business areas receive their initial working capital through appropriations or resources transferred from existing appropriations of funds; they use those capital resources to finance the cost of goods and services. Customer orders generate resources to replenish working capital and permit continuing operations. In FY 1995, the DBOF reported annual revenues of \$76.6 billion.

DBOF Appropriation. Each year, Congress appropriates funds to finance portions of the DBOF. The congressional appropriation for DBOF was \$1.1 billion for FY 1994 and \$945 million for FY 1995. The FY 1995 appropriation was divided among two DBOF business areas. The Defense Commissary Agency Operations business area received \$940 million for commissary operating expenses and the Air Force Supply Management business area received \$5 million.

Audit Objectives

The overall revenue accounts audit objective was to determine whether revenues reported on the FY 1996 DBOF consolidated financial statements were

presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this portion of the audit, we reviewed the FY 1995 financial statements for comparability and determined whether all Defense Business Operations Fund revenue was reported in FY 1995. In addition, we assessed internal controls and compliance with laws and regulations as applicable to the overall audit objective. See Appendix A for a discussion of the audit scope, methodology, and management control program.

Accounting for the Defense Business Operations Fund Appropriation

The FY 1995 DBOF financial statements did not report \$940 million of appropriated funds used by the DBOF for commissary operations. This omission occurred because the appropriated funds were not recorded correctly in the DBOF Appropriations Available account. The Deputy Chief Financial Officer instructed the Defense Finance and Accounting Service (DFAS) to record the appropriated funds as an increase to the Funds With Treasury Operating Program--DBOF account, rather than an increase to the Appropriations Available account. In addition, DFAS did not have adequate management controls to identify and correct the misclassification. Because the \$940 million of appropriations was not recorded in the Appropriations Available account, related revenue (Appropriated Capital Used) was not recognized and recorded in the DBOF accounting records and, thus, was omitted in the financial statements. As a result, the FY 1995 DBOF Consolidated Statement of Operations and Changes in Net Position understated revenues and financing sources by \$940 million and overstated the shortage of revenues and financing sources over expenses by \$940 million.

Accounting for Appropriations

Congress authorizes appropriations, which permit agencies to incur obligations and make payments out of the U.S. Treasury for specified purposes. DoD 7000.14-R, "DoD Financial Management Regulation," Volume 11B, "Reimbursable Operations, Policy and Procedures--Defense Business Operations Fund," December 1994, issued by the Under Secretary of Defense (Comptroller) provides appropriation accounting policy. The debit (DR) and credit (CR) entries used to record the receipt of an appropriation on the proprietary accounting records are:

DR 1013 Funds With Treasury

CR 3211.1 Appropriations Available

DBOF may receive appropriations for two general purposes: to provide working capital and to provide financing for specific projects or tasks. The appropriation to fund the Commissary Operations business area was for a specific task. The entry for recording the use of such an appropriation in the accounting records would be:

DR 3211.1 Appropriations Available

CR 5700 Appropriated Capital Used

This entry recognizes revenue from appropriations used to fund operations.

Deputy Chief Financial Officer Guidance

The Deputy Chief Financial Officer in the Office of the Under Secretary of Defense (Comptroller) issued a memorandum to the Director, DFAS, on November 7, 1995, Subject: "Adjustment of the Defense Business Operations Fund (DBOF) Financial Records and Reports to Reflect DBOF Component Cash Balances." The memorandum instructed DFAS to record the entire amount of a cash transfer of \$1.637 billion to the Defense Agencies in the Net Treasury Balance--DBOF account. The amount transferred included \$940 million of appropriated funds for operations of the Defense Commissary Agency in FY 1995. This resulted in the use of the appropriation being recorded as a Non Operating Change to equity rather than as a source of revenue. As a result, the appropriation was not recognized as revenue in the accounting records and not reported as revenue in the FY 1995 consolidated DBOF financial statements. Consequently, the reported amount for revenues and financing sources was understated by \$940 million, and the reported shortage of revenue and financing sources over expenses was overstated by a like amount. The appropriated portion of the cash transfer should have been recorded in the Appropriations Available account, as required by DoD 7000.14-R. This would have resulted in the appropriation being correctly reported as a source of revenue.

The erroneous instruction occurred because of confusion arising from a change in the budgetary procedure for managing DBOF cash. In FY 1994, cash was held and managed at the DBOF corporate level by budget officials in the Office of the Under Secretary of Defense (Comptroller). Also in FY 1994, approximately \$1.1 billion of appropriated funds to the DBOF were correctly reported as revenue in the financial statements for that year. In FY 1995, previously centrally held DBOF cash balances were transferred to the DoD Components, specifically, the Army, Navy, Air Force, Office of the Secretary of Defense, and Defense agencies. Cash was not transferred to individual Defense agencies, but to the Defense Logistics Agency (DLA) for its management. Included in the cash transferred were operating cash and the appropriation for commissary operations. The appropriation amount was not separately identified in the cash transfer. The guidance issued was correct for the transfer of operating cash as a Non Operating Change to equity. However, the guidance applied to the total amount of both types of cash and was incorrect for the transfer of appropriated cash. If the amounts of the cash being transferred had been separately identified instead of commingled, accounting officials in the Office of the Under Secretary of Defense (Comptroller) would have issued specific guidance for both types of transactions. Nevertheless, accounting officials should apply established accounting policy and principles to all accounting guidance issued. Budgetary practices should not affect accounting practices. Ensuring that accounting instructions issued by the Under Secretary of Defense (Comptroller) comply with applicable accounting principles can improve the accuracy of the DBOF financial statements.

Financial Statement Comparability

The DBOF consolidated financial statements are comparative and reflect the financial activity of both the current and prior fiscal years. Therefore, the FY 1996 consolidated DBOF financial statements will reflect both FYs 1995 and 1996. Normally, procedures used to compute the amounts reported are consistent between the accounting periods represented on comparative financial statements. When an error affecting the prior fiscal year is detected, it should be corrected and explained in a footnote to the financial statements. The Financial Accounting Standards Board issuance "Current Text--Accounting Standards," June 1, 1995, states:

It is necessary that prior year figures shown for comparative purposes be in fact comparable with those shown for the most recent period, or that any exceptions to comparability be clearly brought out.

The error affecting the Appropriated Capital Used and Non Operating Changes lines of the FY 1995 Statement of Operations and Changes in Net Position should be corrected in the FY 1995 balances reported in the FY 1996 comparative statements. In addition, a footnote explaining the error should also be included in the FY 1996 comparative statements.

Comparative Analysis

In FY 1994, Congress appropriated approximately \$1.1 billion for DBOF, which was properly reported as Appropriated Capital Used in the FY 1994 DBOF Consolidated Statement of Operations and Changes in Net Position. In FY 1995, the \$940 million appropriated for commissary operations was not reported in this manner.

Analysis of the FY 1995 comparative financial statements shows a significant difference between the Appropriated Capital Used reported for FY 1994 and FY 1995. The amount reported as Appropriated Capital Used in the FY 1995 financial statements was \$14 million compared to \$1.16 billion in the FY 1994 financial statements, a 99-percent decrease.

Significant variations from previously reported amounts typically reflect a change in accounting policy or an error. DoD 7000.14-R, "DoD Financial Management Regulation," Volume 6, "Reporting Policies and Procedures," February 1996, requires DFAS to compare current-year financial statements with those of the prior year to identify any unusual trends, errors, or inconsistencies and to take appropriate action. Had DFAS performed the required comparative review, the omission of Appropriated Capital Used in the FY 1995 financial statements could have been identified and action taken to correct the error before statements were issued. The lack of a comparative review represents a material management control weakness. By implementing

procedures requiring the comparative analysis of the financial statements, DFAS can better identify significant errors that could otherwise go undetected.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Under Secretary of Defense (Comptroller):

- a. Rescind the memorandum (November 7, 1995, Subject: "Adjustment of the Defense Business Operations Fund (DBOF) Financial Records and Reports to Reflect DBOF Component Cash Balances") instructing the Defense Finance and Accounting Service to report the entire amount of the cash transfer from the Defense Business Operations Fund corporate level to the Defense Agencies segment as a Non Operating Change to equity.**

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service Comments. The Deputy Chief Financial Officer and the Defense Finance and Accounting Service nonconcurred, stating that the instructions contained in the memorandum were correct for the Military Departments and all Defense Agencies except for the Defense Commissary Agency. Rather than rescinding the entire memorandum, the Under Secretary of Defense (Comptroller) issued another memorandum modifying the instructions to the Defense Commissary Agency.

Audit Response. The comments are responsive to the recommendation. We agree that the action taken by the Under Secretary of Defense (Comptroller) was appropriate to correct the error.

- b. Establish a management review procedure to ensure that accounting instructions issued to the Defense Finance and Accounting Service and Defense Business Operations Fund Components comply with policies and procedures contained in DoD 7000.14-R, "DoD Financial Management Regulation."**

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service Comments. The Deputy Chief Financial Officer and the Defense Finance and Accounting Service nonconcurred, stating that accounting instructions issued by the Under Secretary of Defense (Comptroller) undergo an extensive management review process that includes review and coordination by numerous officials. Their response acknowledged that an exception may occasionally go undetected and stated that an additional review process or procedure was unnecessary.

Audit Response. The comments are responsive to the recommendation. Although the established review process failed in this instance, we agree that the establishment of an additional layer of review is unnecessary.

Accounting for the Defense Business Operations Fund Appropriation

2. We recommend that the Director, Defense Finance and Accounting Service:

a. Implement the DoD 7000.14-R, "DoD Financial Management Regulation," requirement that proposed financial statements be compared with those of the prior period to identify any unusual trends, errors, inconsistencies, or departures from established accounting policies.

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service comments. The Deputy Chief Financial Officer and the Defense Finance and Accounting Service concurred with the recommendation. The response stated that DFAS has a process in place to identify any unusual trends, errors, inconsistencies, or departures from established accounting policies. DFAS officials identified the difference between FY 1994 and FY 1995 financial reports. However, because no procedures were in place at that time to record cash at the Defense Commissary Agency business-area level, the \$940 million appropriation was reported as a Non-Operating Change to equity in the Treasury accounts.

Audit Response. The comments are responsive.

b. Restate the Appropriated Capital Used and Non Operating Changes lines of the FY 1995 Consolidated Statement of Operations and Changes in Net Position shown in the FY 1996 comparative Defense Business Operations Fund financial statements.

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service comments. The Deputy Chief Financial Officer and the Defense Finance and Accounting Service concurred.

Audit Response. The comments are responsive. We assume the FY 1996 DBOF financial statements will reflect the adjustments. Those statements will be audited.

c. Report the departure from the applicable accounting principles for the FY 1995 Appropriated Capital Used account balance in the footnotes to the FY 1996 comparative Defense Business Operations Fund financial statements.

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service comments. The Deputy Chief Financial Officer and the Defense Finance and Accounting Service nonconcurred with the recommendation, stating that the restatement of Appropriated Capital Used and Non Operating Changes lines was because of an error and not because of a departure from accounting principles. The error will be explained in the footnotes to the FY 1996 financial statements.

Audit Response. The comments are responsive to the recommendation. The intent of the recommendation was to alert readers of the financial statements to the reason for the change in the amounts reported as Appropriated Capital Used and Non Operating Changes in Net Position for FY 1995. Explaining that the

Accounting for the Defense Business Operations Fund Appropriation

and Non Operating Changes in Net Position for FY 1995. Explaining that the amounts reported changed because of an error meets the intent of the recommendation.

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Part II - Additional Information

Appendix A. Scope and Methodology

Scope

As part of our financial-related audit of "Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund," we examined the accounting practices used for recording Appropriated Capital Used. This review included determining the amount reported in the previous fiscal year, identifying sources of appropriated funds for the DBOF, and evaluating the procedures used to recognize and report Appropriated Capital Used.

Methodology

We performed this financial-related audit during the period May 1996 through August 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD, and Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. We did not use statistical sampling in this review. We also did not use computer-processed data in this review.

Organizations and Individuals Visited or Contacted

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987,* requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.

Scope of Review of Management Control Program. We reviewed management control procedures regarding the consolidation of DBOF financial data. We also reviewed management's self-evaluation of those management controls.

Adequacy of Management Controls. We identified a material management control weakness as defined by DoD Directive 5010.38 relating to the preparation of the DBOF consolidated financial statements. No controls had been established to ensure the comparability of financial information for the fiscal years presented on the financial statements. Management asserted in response to the draft report that a process is in place, although it was not specified when that process was implemented. The adequacy of that process will be continuously tested in audits of DBOF financial statements and should also be emphasized in DFAS self-evaluations. A copy of this report will be provided to the senior DFAS official responsible for management controls.

Adequacy of the Defense Finance and Accounting Service Self-Evaluation. DFAS identified the financial accounting process and system as an assessable unit and correctly identified the risk as high. DFAS officials conducted the required evaluation and identified inadequate analytical review of account balances as a material weakness. DFAS implemented corrective actions to review data reported by the DoD Components to the DFAS centers. However, DFAS did not implement a comparative review of account balances in the financial statements of the current and prior fiscal years.

Appendix B. Prior Audits and Other Reviews

Inspector General, Department of Defense

The Inspector General, Department of Defense, previously issued three reports on issues identified during the audit of the revenue accounts in the FY 1996 Defense Business Operations Fund financial statements:

IG, DoD Report No 97-040, "Distribution Depot Over-Ocean Second Destination Transportation Costs," December 10, 1996. This report states that transportation costs applicable to other DoD organizations were erroneously charged to the Distribution Depot business area of the Defense Business Operations Fund. Our review of three summary bills of 104,878 shipments, totaling \$26.8 million, showed that \$10.5 million (39 percent) was erroneously charged to the Distribution Depot business area. After our review, a management consulting firm hired by DLA found an additional \$41.8 million (27 percent) of \$155.7 million paid from April 1995 through March 1996 was not applicable to the Distribution Depot business area. As a result, the Distribution Depot business area paid for material amounts of transportation costs that should have been paid by other DoD organizations. In FY 1995, the Distribution Depot business area lost \$102 million in over-ocean second destination transportation costs; this loss was caused partly by erroneous bills. Management actions planned were responsive to the recommendations.

IG, DoD Report No. 96-198, "Defense Logistics Agency Revenue Eliminations," July 22, 1996. This report states that when the DLA made sales to other organizations that are part of the DBOF, revenues from these sales were not eliminated from the amount reported in the FY 1995 financial statements, as required by Under Secretary of Defense (Comptroller) guidance. Consequently, revenue of \$13.3 billion, reported by DLA in the FY 1995 Consolidated Financial Statements of the DBOF, was overstated by \$8.4 billion (63 percent). Revenue was also overstated by \$.6 billion in the DLA financial statements. Management actions planned were responsive to the recommendations.

IG, DoD Report No. 96-160, "Defense Business Operations Fund Equity Transfer--Defense Commissary Agency," June 13, 1996. This report states that at the direction of an official in the Office of the Under Secretary of Defense (Comptroller), the Defense Commissary Agency erroneously reported a \$251.6 million transfer of equity from the DLA segment of the DBOF as revenue in the FY 1995 financial statements. As a result, revenues and net results of operations were overstated by \$251.6 million in the FY 1995 consolidated financial statements of the DBOF. The Deputy Chief Financial Officer nonconcurred with the finding and recommendations. Mediation has been requested to resolve the disagreement.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
 Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
 Deputy Chief Financial Officer
 Deputy Comptroller (Program/Budget)
 Director, Accounting Policy
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
 Director (Audit Liaison and Follow Up)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
 Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Appendix C. Report Distribution

Non-Defense Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Under Secretary of Defense (Comptroller)/ Defense Finance and Accounting Service Comments



**OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100**



DEC 3 1996

MEMORANDUM FOR DIRECTOR FOR FINANCE AND ACCOUNTING, DOD INSPECTOR GENERAL

SUBJECT: Audit Report on Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements (Project No. 5FD-2020.02)

This is a joint response, by the Office of the Under Secretary of Defense (Comptroller) and the Defense Finance and Accounting Service, to the Department of Defense Inspector General draft report, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," dated October 31, 1996 (Project No. 5FD-2020.02).

We concur with only two of the five recommendations. Detailed comments on all five of the recommendations are provided in the enclosure.

The opportunity to comment on the draft report is appreciated. The point of contact for this matter is Mr. Thomas W. Short. Mr. Short may be reached by telephone at (703) 697-6875, DSN 227-6875 or e-mail: shortt@ousdc.osd.mil.

A handwritten signature of Alvin Tucker.

Alvin Tucker
Deputy Chief Financial Officer

Attachment

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service Comments

**JOINT OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND
DEFENSE FINANCE AND ACCOUNTING SERVICE
RESPONSE TO DRAFT AUDIT REPORT**

**Appropriated Capital Used in the FY 1995
Defense Business Operations Fund Financial Statements
Project No. 5FD-2020.02, dated October 31, 1996**

* * * *

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. The Inspector General recommends that the Under Secretary of Defense (Comptroller):

a. Rescind the memorandum (November 7, 1995, Subject: "Adjustment of the Defense Business Operations Fund (DBOF) Financial Records and Reports to Reflect DBOF Component Cash Balances") instructing the Defense Finance and Accounting Service (DFAS) to report the entire amount of the cash transfer from the DBOF corporate level to the Defense Agencies as a Non Operating Change to Equity.

JOINT OUSD(C)/DFAS RESPONSE: Do not concur. As noted in the draft audit report, the instructions contained in the referenced memorandum were correct for the Military Departments and all Defense Agencies except for the Defense Commissary Agency. Therefore, the referenced memorandum need not, and should not, be rescinded. Instead, a memorandum has been issued to modify that portion of the instructions which were not applicable to the Defense Commissary Agency. A copy of the corrective memorandum is attached for your information.

b. Establish a management review procedure to ensure that accounting instructions issued to the DFAS and the DBOF Components comply with policies and procedures contained in the DoD 7000.14-R, "Financial Management Regulation."

JOINT OUSD(C)/DFAS RESPONSE: Do not concur. This recommendation assumes that a management review procedure does not exist. That is not the case. Accounting instructions issued by the Office of the Under Secretary of Defense (C) undergo an extensive management review process that includes review and coordination by: (1) staff members within the initiating office; (2) directors of the initiating office; (3) the Office of Deputy General Counsel (Fiscal); (4) other associated OSD offices as appropriate; and (5) the DFAS. It is acknowledged that, despite such an extensive review and coordination process, an exception occasionally may go undetected; however, the presence of an exception does not equate to the absence of a management review procedure. Nor is the establishment of another management review process/procedure necessarily the appropriate response whenever an exception is excluded from initial guidance.

Under Secretary of Defense (Comptroller)/Defense Finance and Accounting Service Comments

2. We recommend that the Director, Defense Finance and Accounting Service:

- a. Implement the DoD 7000.14-R "Financial Management Regulation," requirement that proposed financial statements be compared with those of the prior period to identify any unusual trends, errors, inconsistencies, or departures from established accounting policies.

JOINT OUSD(C)/DFAS RESPONSE: Concur. The DFAS has a process in place to review DBOF financial reports and identify any unusual trends, errors, inconsistencies, or departures from established accounting policies. The difference between the FY 1994 and FY 1995 financial reports was identified. Since no procedures were in place, at that time, to permit the recording of cash at the DeCA business area level, the \$940 million appropriation was included as a non-operating change in the non-expenditure transfer documents processed at the Treasury Department to establish the DBOF subnumbered accounts.

- b. Restate the Appropriated Capital Used and Non Operating Changes lines of the FY 1995 Consolidated Statement of Operations and Changes in Net Position shown in the FY 1996 comparative DBOF financial statements.

JOINT OUSD(C)/DFAS RESPONSE: Concur.

- c. Report the departure from the applicable accounting principles for the FY 1995 Appropriated Capital Used account balance in the footnotes to the FY 1996 comparative DBOF financial statements.

JOINT OUSD(C)/DFAS RESPONSE: Do not concur. The restatement of Appropriated Capital Used and Non Operating Changes of the FY 1995 Consolidated Statement of Operations and Changes in Net Position was the result of an error and not the result of a departure from accounting principles. An explanation of the error will be included in the footnotes to the FY 1996 comparative DBOF financial statements.

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

F. Jay Lane
David C. Funk
Byron B. Harbert
Mark A. Ives
Deborah Curry
Betty J. Hallman

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements

B. DATE Report Downloaded From the Internet: 10/27/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: VM **Preparation Date** 10/27/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.